Appl AAT Case 12,615; Australian Dairy Corp & C'ner of Tax, Re (1998) 38 ATR 1074

[PRIVY COUNCIL.]

THE PRODUCERS' CO-OPERATIVE DISTRIBUTING SOCIETY LIMITED . . . } APPELLANT;
APPELLANT,

AND

THE COMMISSIONER OF TAXATION (N.S.W.) RESPONDENT.
RESPONDENT,

ON APPEAL FROM THE HIGH COURT OF AUSTRALIA.

PRIVY COUNCIL.
1947.
July 28-30.
Dec. 18.

Lord Porter, Lord Simonds, Lord Uthwatt, Lord Normand, Lord MacDermott.

Income Tax (N.S.W.)—Assessable income—Exemption—Co-operative rural society—Manufacture, treatment or disposal of "agricultural products of its members"—Principal business of rural society—Sale on commission of butter manufactured by member co-operative societies—"Use of land"—Income Tax Management Act 1941 (*N.S.W.*) (*No.* 48 *of* 1941) *s.* 19 (*o*)—*Co-operation Act* 1923-1941 (*N.S.W.*) (*No.* 1 *of* 1924—*No.* 44 *of* 1941), *ss.* 5, 7.

Section 19 (o) of the *Income Tax Management Act* 1941 (N.S.W.) provides that "the income of a rural society registered as such under the *Co-operation Act*, 1923-1941 . . . if the principal business of that rural society is the manufacture, treatment or disposal of the agricultural products (as defined in that Act) or livestock of its members" shall be exempt from income tax.

Section 5 of the *Co-operation Act* 1923-1941 (N.S.W.) defines "Agricultural products" as the "products of any rural industry" and "Rural industry" as "the cultivation or use of land for" *inter alia* "any . . . dairying, or rural purpose."

The principal business of the appellant, a rural society registered as such under the *Co-operation Act* 1923-1941, was the sale on commission on behalf of members, which were also registered co-operative societies, of butter manufactured by such last-mentioned co-operative societies from cream sent to them by their members, being dairy farmers.

Held, that the butter thus disposed of by the appellant was not "agricultural products" within the meaning of s. 19 (o) of the *Income Tax Management Act* 1941 and accordingly the appellant was not entitled to the exemption conferred by that section.

Butter resulting from factory operations and made out of cream bought from many sources, is not a product of the use of the factory land.

Decision of the High Court of Australia: *The Producers' Co-operative Distributing Society Ltd.* v. *Commissioner of Taxation (N.S.W.)* (1944) 69 C.L.R. 523, affirmed.

APPEAL from the High Court to the Privy Council.

The Producers' Co-operative Distributing Society Ltd. appealed, by special leave, to the Privy Council against a judgment of the High Court (1) affirming a judgment of the Full Court of the Supreme Court of New South Wales (2). That judgment upheld a decision of the Board of Appeal constituted by the *Income Tax Management Act* 1941 (N.S.W.), which disallowed the appellant's claim to exemption from income tax under s. 19 (o) of that Act.

The facts and the relevant statutory provisions sufficiently appear in the judgment hereunder.

Judgment reserved.

Sir *Valentine Holmes* K.C. and *Donovan* K.C., for the appellant.
Weston K.C. and *Davies* K.C., for the respondent.

Dec. 18.

LORD UTHWATT delivered the judgment of their Lordships, which was as follows:—

This is an appeal by special leave by The Producers Co-operative Distributing Society Ltd., from a judgment of the High Court of Australia (1) dated 11th December 1944, affirming a judgment of the Full Court of the Supreme Court of New South Wales dated 4th October 1944 (2). That judgment upheld a decision dated 10th May 1944, of the Board of Appeal constituted by the New South Wales *Income Tax Management Act* 1941 which disallowed the appellant's claim to exemption from income tax under s. 19 (o) of the *Income Tax Management Act* 1941 of New South Wales. The point raised has a considerable practical importance. It is also one of some difficulty as appears from the fact that *Jordan* C.J. in the Full Court and *Rich* and *Starke*, JJ. in the High Court expressed dissenting opinions.

The appellant is a rural society registered as such under the *Co-operation Act* 1923-1941 of the State of New South Wales. Its members are some 9,500 in number. Most of the members are individual farmers but nearly 100 co-operative societies registered under the Act are also members. The business of the appellant

(1) (1944) 69 C.L.R. 523.

(2) (1944) 45 S.R. (N.S.W.) 44; 61 W.N. 269.

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consists in the sale on commission of butter, bacon and other like commodities. Its principal business consists in selling on behalf of those of its members which are co-operative societies butter made by those societies from cream sold to them by farmers.

This completes the tale of the facts save for one important matter. There was uncontradicted evidence that butter-making exists as a distinct industry in the State. In the early days it was the practice of farmers to make their own butter. Proprietary companies then came upon the scene and started building creameries in the various milk-producing centres. The farmer's dairying practice changed and he contented himself with separating his cream and sending it to the creamery. With the growth of the co-operative movement butter factories were built all over the State, the proprietary companies being pushed aside by the co-operative societies. The effect of the evidence is pointedly and accurately summed up by *Latham* C.J. in the statement that it " shows that to-day the making of butter has become a factory process, separated from the farm " (1).

The provision containing the exemption from income tax on which the appellant relies is s. 19 of the *Income Tax Management Act* 1941 of New South Wales and it so far as relevant runs as follows: " The following income shall be exempt from income tax:—(o) . . . the income of a rural society registered as such under the *Co-operation Act* 1923-1941 . . . if the principal business of that rural society is the manufacture, treatment or disposal of the agricultural products (as defined in that Act) or livestock of its members."

The incorporated definition contained in the *Co-operation Act* 1923-1941 is in the following terms:—" Unless the context or subject matter otherwise indicates or requires—' Agricultural products ' means ' products of any rural industry.' ' Rural industry ' means the cultivation or use of land for any agricultural, pastoral, dairying, or rural purpose."

Agricultural products means therefore the products of the cultivation or use of land for any agricultural, pastoral, dairying or rural purpose.

The question which emerges for decision is whether the butter made by the manufacturing societies and sold for their account—it may be conveniently called the relevant butter—is *vis-à-vis* the appellant society " an agricultural product of its members." If it is, then, inasmuch as the principal business of the appellant, which is clearly a rural society, consists of the disposal of the relevant butter, the claim for exemption is made out. The appellant's

(1) (1944) 69 C.L.R., at p. 530.

submissions are that the relevant butter is a product of the use of the farmer's land for a dairying purpose, or alternatively a product of the use of the factory land for that purpose, and therefore an agricultural product. In connection with its first submission the appellant contends that the phrase "products of its members" does not connote production by its members.

It is convenient to deal first with the alternative submission of the appellant. In their Lordships' view it is inaccurate to describe butter resulting from factory operations made out of cream bought from many sources, as a product of the use of the factory land.

The use of the factory land necessarily entered into the operation of making the relevant butter—the use of land enters into most forms of human activity—but to attribute the product to the use of the factory land rather than to the raw materials and the operations to which those materials are subjected is to neglect the substance of the matter, and to seize upon a feature common to all factory operations as the feature marking out the origin of the product of a particular factory operation.

The first contention of the appellant cannot be disposed of so easily.

In connection with it the appellant sought to draw from a detailed examination of the substantive provisions of the *Co-operation Act* an inference as to the meaning proper to be attributed to the definition of agricultural products as that definition is incorporated in the *Income Tax Management Act*. Upon the legitimacy of such an examination and its effect, if it be admissible, their Lordships agree with the opinion expressed by *Latham* C.J. (1). To interpret the incorporated definition in the second Act by an analysis of its exact meaning in the substantive provisions of the first Act, where that definition applies only unless the context or subject matter otherwise indicates or requires, is not a rational procedure.

It is however permissible, inasmuch as under the *Co-operation Act* the term agricultural products is almost entirely used in connection with rural societies, to take into account the activities which are open to those societies under the *Co-operation Act*. They may explain the general meaning and application of the definition. The only relevant matter however that emerges from a consideration of s. 7 of the *Co-operation Act*, where those activities are enumerated, is that in them a distinction is drawn between agricultural products and products which are manufactured out of agricultural products or result from their treatment. In the general contemplation of the definition therefore treatment of an agricultural product may

(1) (1944) 69 C.L.R., at pp. 531, 532.

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result in an article which is not an agricultural product within the definition.

The point at issue under the first contention of the appellant is as *Rich* J. observes, a narrow one and it is within a small compass. Their Lordships agree with *Rich* J. (1) that products include products derived at some remove from the farmer's land. It may be that agricultural products include articles which are not agricultural produce, but it does not follow that all articles falling according to common conception within the *genus* agricultural produce—and butter is such an article—are agricultural products as defined. The definition demands that the facts bearing on the production of the particular article under consideration are to be taken into account. The treatment to which the raw material is subjected and the circumstances in which it is accorded that treatment may be such that the finished article cannot be fairly regarded as a product of the use of the land to which the raw material owes its origin.

In this case the relevant land is exclusively the farmer's land. The use to which that land is put is the production of milk and cream and, stating the case at its highest in favour of the appellant, production with a view to the subsequent conversion of cream into butter. Their Lordships are prepared to assume that, did the farmer himself make the butter, such butter would be an agricultural product within the meaning of the definition. In such a case the farmer uses or cultivates his land for the production of butter just as he uses or cultivates it for the production of milk and cream. But from the fact that butter may be an agricultural product as defined it does not in their Lordships' view follow that butter which is not solely the product of the farmer's use or cultivation of his land must also be an agricultural product as defined. In this particular case such use or cultivation results only in one definite product—cream. At that stage a distinct organized industry appears on the scene. Is the finished product produced by the factory operations—the relevant butter—to be properly characterized as the product of the use of the land to which the raw material owes its origin ? Or, to put the point in another way, are the operations of this industry such that rightly viewed they form part of the chain linking the ultimate result—the relevant butter— to the use of the farm land ? The exact statement of a question usually supplies the answer. In this case it does not, for the question is largely one of degree ; and it does not surprise their Lordships that different answers have been given to it. In their Lordships'

(1) (1944) 69 C.L.R., at p. 533.

view the answer is in the negative. In their opinion an affirmative answer would fail to give due weight to the place held by manufacturing societies in the working economy of the State. There are two industries, the farming industry and the butter-making industry. The industries are indeed closely related, but they are independent and the product of the latter industry is not in any real sense the product of the former industry. The appellant's first contention in their Lordships' opinion therefore fails.

The conclusions at which their Lordships have arrived render it unnecessary for them to express any opinion upon the meaning of the phrase " of its members " and they accordingly do not propose to deal with that matter.

Their Lordships will humbly advise His Majesty that this appeal be dismissed. The appellant will pay the costs of the appeal.

Solicitors for the appellant, *Duncan Barron & Co.*, by *Herbert, Oppenheimer, Nathan & Vandyk.*

Solicitor for the respondent, *F. P. McRae*, Crown Solicitor for New South Wales, by *Light & Fulton.*

J. B.